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C O N F I D E N T I A L ALGIERS 001302

SIPDIS

E.O. 12958: DECL: 06/28/2015
TAGS: ECON EFIN EINV PGOV AG
SUBJECT: THE KHALIFA LEGACY: BAD HABITS PERSIST AS ALGERIA WAITS FOR BANKING REFORM

REF: A. ALGIERS 1233
¶B. ALGIERS 491

Classified By: Ambassador Richard W. Erdman, reasons 1.4(b)(d).

¶1. (C) At least one bank in Algeria's public-dominated banking industry appears to have retained some of the bad habits that caused the collapse of the entire sector in 2003. Ambassador and Econoff learned May 24 from the president of a large western bank in Algeria that the specialized Algerian Bank for Rural Development (BADR) has made a loan valued in the "hundreds of millions of dollars" to paper manufacturer Tonic Emballage, considered the largest printer in Africa and an important supplier of paper products to the domestic, regional, and European markets. According to the source, the loans were made "with only a phone call" without any evaluation of the borrower. The source had heard speculation that the value of the loan could be as high as $500 million.

¶2. (C) The recipient of this unquestioned loan, the Tonic Emballage paper company, has achieved somewhat legendary notoriety in Algeria. The 10 percent annual growth of Tonic, its 2005 unprecedented purchase of 160 printing units and several other presses, and a planned doubling of the workforce from 5,500 in 2005 to 10,000 by the 2006-7 period are in response to robust growth and good contract potential. Tonic estimates its 2005 exports will be worth 35 million Euros. Certain aspects of the Algerian market make it a sensible location for investment in the paper industry: low cost of energy for energy-intensive processes, the availability of desalinized water to use in manufacturing, and a skilled, low-cost labor force. Nonetheless, the apparent ease with which the BADR loan was supposedly approved contradicts the spirit of Algerian banking reform. It also raises the prospect that Algerian banks are still capable of damaging the national banking system by granting loans that are not risk-evaluated. The state-owned banking sector has historically made "directed," non-performing loans to state-owned enterprises to keep state sectors afloat. Unchecked loans to private firms are likely to be more rare, since Algeria has only had a significant private sector since the mid-1990s.

¶3. (C) The granting of an unquestioned loan resembles the tactics of the former Khalifa Bank from 1998 to 2003, when the Khalifa family conglomerate opened private retail and institutional banking services with the approval of the Central Bank. The owners completely replaced the Central Bank-approved management team shortly after receiving GOA approval, and Khalifa Bank proceeded to make generous loans to family and related businesses, sending millions of dinar overseas disguised as payments for illegally overbilled goods or for projects that never materialized. The government and the broad public attributed the ensuing collapse to inadequate Central Bank regulation of the banking industry, resulting in the loss of $2 billion from the savings, pensions, and other deposits of public and private enterprises, individuals, and even state-owned banks.

¶4. (C) The BADR loan to Tonic appears to have bypassed normal oversight procedures for loans of that size, indicating that in practice the Central Bank does not exercise effective supervisory authority in the banking sector, even when it comes to large transactions. A former Canadian Treasury official who has been consulting independently with the Ministry of Finance since 1997 indicated to econoff June 18 that banking reform has been extremely difficult to achieve because of the power wielded by public banks. They have for years stymied Minister Delegate of Financial Reform Karim Djoudi's efforts to move toward privatization and efficient industry procedures. Djoudi has been frustrated at the lack of progress. For example, in a September 2004 conversation, Algerian Central Bank officials insisted that central banks around the world were not responsible for regulation of their national banking industries -- an indication of the Central Bank's consistent abdication of its own supervisory role.

¶5. (C) Finance Minister Medelci's recent assurances to Ambassador (ref A) that three banks would be privatized soon -- something he subsequently announced publicly this week -- could be easier to declare than implement, given the Finance Ministry's perennial and unfinished struggle to regulate the industry. However, former Finance Minister Benachenhou's removal of three public bank CEOs in May, and Medelci's statement that the state would privatize majority stakes in

public banks, appear to be more robust efforts to shake-up the system. Much as WTO accession will give the GOA the political cover it needs to enact new, unpopular rules, the gathering momentum for bank privatization has the potential to reform the industry in ways that internal efforts have been unable to achieve.

ERDMAN